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-RESEARCH ARTICLE-

BANK CREDITS AND THEIR ROLE IN FINANCIAL SUSTAINABILITY - A STUDY AT THE NATIONAL BANK OF IRAQ (2014-2023)

Ksma Saber Awdh

University of Al-Qadisiyah y, College of
Administration and Economics, Department of Business
Administration, Al-Diwaniyah, Qadisiyah Province, Iraq,
Email: Ksma.alsltan@qu.edu.iq

—Abstract—

The financial performance of the banks is of significant importance for the managers, shareholders, investors, and the general public across the globe. The research aims to analyse the impact of credit policy on financial safety in the National Bank of Iraq over the 2014 to 2023 period. For this purpose, time series data is collected from the official financial reports issued by the bank and published on the official website of the Iraq Stock Exchange. The credit policy was measured by the cash and contractual credit growth rates, and the financial safety index was calculated by combining different indicators using the Bankometer model. The study's findings indicated that credit policy is inversely related to financial safety, indicating that the bank's expansion in granting credit may negatively affect the financial safety index of the bank. Based on the findings, the study recommends that policymakers emphasise financial safety and make it the ultimate goal of the bank by focusing on its sub-indicators, especially the capital adequacy index and the bad debt provision, as they represent the first line of defence to confront credit risks.

Keywords: Credit Policy, Cash Credit, Contractual Credit, Financial Safety.

INTRODUCTION

Financial stability plays an important role in maintaining the health of any bank, which is an important financial intermediary and collector and distributor of funds in an economy. The banking sector is a cornerstone of any country's economic system, serving as a primary conduit for financial intermediation and economic stability. Banks

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act as profit-seeking intermediaries between lenders and borrowers in economies (Kwashie et al., 2022). They play a critical role in mobilising savings, providing credit, and fostering investment, collectively contributing to sustainable economic development. However, the sector is heavily influenced by a host of economic, financial, and regulatory variables that can significantly affect the performance and stability of financial institutions. Maintaining financial stability is crucial for banks to continue supporting economic growth by lending money to people and businesses and ensuring the bank's survival (Alfiana et al., 2024). These challenges necessitate formulating effective policies and financial strategies to safeguard the sector against potential risks and ensure financial safety within the broader business environment (Konovalova et al., 2016; Swamy, 2014).

One of the most essential activities the banks perform is the granting of credit, which is instrumental in activating banking operations and generating revenues. This function not only supports the operational viability of banks but also fosters depositor confidence, a critical factor in attracting and retaining financial resources (Porretta et al., 2020). Credit granting, however, is fraught with risks, particularly credit risks, among the most significant threats to financial stability in banking institutions. Overextension in granting loans or exceeding prescribed credit limits can lead to liquidity crises, where banks may fail to meet their obligations, thus jeopardising their financial safety (Noman & Isa, 2021).

Therefore, the formulation of effective credit policies is a crucial element in mitigating these risks. A well-designed credit policy provides a structured framework for managing the credit-granting process, balancing the dual objectives of profitability and risk management. By adhering to such policies, banks can safeguard their financial resources and contribute to the stability of the banking and financial system. Effective credit policies also play a vital role in maintaining public trust, as they ensure the prudent allocation of credit and the timely fulfilment of financial obligations (Ayodele, 2014). In addition to mitigating risks, credit policies have a broader impact on financial safety, a measure of a bank's ability to withstand economic shocks and financial imbalances. Financial safety is underpinned by capital adequacy, liquidity, and robust internal controls. These elements form the first defence against financial instability and credit risks. Banks that prioritise financial safety through sound credit policies enhance their operational resilience and strengthen the financial sector's overall stability, benefiting economies at large (faisal Djihad, 2021; Mathur, 2022). In particular, the credit-granting function is a critical mechanism for utilising financial resources across various credit fields and operations. An appropriate and well-structured credit policy serves as a safeguard to preserve these resources, ultimately contributing to the financial safety of banks.

Given the vital role of credit policies and their impact on financial safety, this study aims to explore the relationship between them in the National Bank of Iraq from 2014 to 2023. The success or failure of this policy is one of the important indicators of financial soundness. The National Bank of Iraq is chosen as a case study because it is one of the oldest banks in the country, established in 1995 and registered in the same year in the Iraq Stock Exchange with a capital of (400) million Iraqi dinars. 2004, it was listed in the market with a capital of (1.143) million Iraqi dinars. It is a bank that continues its work, submits its financial statements on time, and has not stopped its activity during the years of research. Therefore, an in-depth exploration of the relationship between banking credit policies and financial safety is necessary in the National Bank of Iraq context. More specifically, the research delves into the impact of credit policy indicators, such as cash and contractual credit growth rates, on the bank's financial safety. Moreover, the study utilises the Bankometer model to measure financial safety and analyses key metrics, including capital adequacy and bad debt provisions. This comprehensive approach enables the study to highlight the relationship between credit policy expansion and financial safety, offering critical insights and recommendations to enhance risk management practices and ensure financial stability within the banking sector. Particularly, the following research questions are going to be addressed by the study:

- What are the levels of credit policy and financial safety in the bank under study?
- Is there a correlation between credit policy and financial safety?
- To what extent does credit policy influence the financial safety of the bank under study?

After this brief introduction, the remaining study sections are ordered: literature review is given in section 2. Section 3 provides a theoretical framework. The research methodology is given in section 4. Section 5 provides results and discussions, and section 6 provides the study's conclusion.

LITERATURE REVIEW

The relationship between credit policy and financial safety is a critical area of study in the banking sector, emphasising sound credit practices' role in ensuring institutional stability. Credit policy is a structured framework guiding credit-related decisions, balancing risk and profitability. Hagos (2010) states that effective credit policies consider internal and external factors to align operations with strategic goals. Highlights that such policies minimise errors and maintain operational flexibility, while Porretta et al. (2020) emphasise their role in mitigating credit risks. Financial safety, a bank's ability to withstand economic shocks, is supported by indicators like capital adequacy, liquidity, and asset quality (Mathur, 2022). Swamy (2014) describes financial safety as essential for maintaining operational continuity, supported by effective regulation, robust infrastructure, and sound risk management practices (faisal Djihad, 2021).

The literature has shown that the relationship between credit policy and financial safety is complex on empirical fronts. Konovalova et al. (2016) argued that well-structured credit policies ensure prudent resource allocation, reducing the risk of loan defaults. However, (Ayodele, 2014) cautioned that excessive credit expansion may undermine financial safety, a finding echoed in this study's analysis of the National Bank of Iraq, which observed an inverse relationship between credit policy indicators and financial safety. In the context of developing economies like Iraq, (Noman & Isa, 2021) stress that economic volatility and regulatory gaps intensify credit risks, making effective credit policies essential. Zhavoronok et al. (2022) studied the credit services market's role in banks' financial performance in Ukraine. They found that an increase in the capital of banking systems led to stability in banking performance. Kwashie et al. (2022) studied the role of credit risks on the financial performance of commercial banks in Ghana over the 2013 to 2018 period. Using the random effects model, the credit risk hurts financial performance. Similarly, Alfiana et al. (2024) reviewed the role of credit risk management in financial stability and concluded that effective risk management strategies were necessary to reduce potential losses.

Based on the above literature, the following hypothesis is formulated:

H1: *Credit policy (with its indicators) significantly impacts financial soundness.*

Literature Gap

The review of extant literature indicates that relatively less attention has been paid to the relationship between financial safety and credit policy, particularly in the context of the banking sector in Iraq. Therefore, the present study fills this literature gap by analysing the role of credit policy in financial safety by considering the National Bank of Iraq as a case study and providing empirical insights into the Iraqi banking sector, emphasising the importance of balancing credit expansion with risk management to enhance financial safety.

THEORETICAL FRAMEWORK

The Concept of Credit Policy

The credit policy occupies an important place in the bank as it is the primary guide to achieve most of its activities and has the most important role in achieving its strategic objectives desired by the bank's management, which has full authority to make any amendments to it to keep pace with developments in the banking market. It was defined by (Hagos, 2010) as a set of specific procedures set by senior management that consider all the internal and external circumstances and factors of the bank, with the necessity of informing employees of these procedures, whether inside the bank or its branches. Likewise, (Ayodele, 2014) defined it as the appropriately written policy for granting

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credit that ensures the integrity of performance and the achievement of the desired goals. Defined it as a set of conditions and guiding standards that ensure the unified treatment of one subject while ensuring trust between employees and management in a way that makes them work without hesitation or fear of making mistakes, in addition to the availability of flexibility in procedures without referring to the upper administrative levels, and accordingly the researcher can define the credit policy as a set of written and announced foundations and standards (for employees and the public) set by the senior management in the bank, and accordingly it is consistent with the general policy of the country, which must be worked on when granting bank credit (cash and contractual) with the necessity of updating, following up and evaluating that policy in a manner consistent with the developments and events that appear in the changing environment of banking work.

The most important objectives of credit policy are as follows: It contributes to rationalising the bank's credit decisions by identifying the areas in which funds are invested, which ensures the formation of a high-quality credit portfolio. It is considered a guidance for the bank's various departments because the policy is written and documented, preventing conflict in making credit decisions. The policy determines the powers of each administrative and organisational level within the bank to grant bank credit. The policy aims to create a customer base with credit eligibility based on the credit rating accepted by the bank, which contributes to reducing the volume of bad debts. It is considered a supervisory and guiding tool as it plays a vital role in following up on the methods of granting credit in light of effective internal control systems.

Financial Safety

One of the recent indicators that has received increased attention is its role in strengthening the banking sector. It is part of the components of financial stability, which has become a guide to the financial health and safety of financial and banking institutions in the country. The safety indicator has become a good reflection of the development and growth of the economic situation and its preservation, which requires monitoring and evaluating these indicators by those in charge. (Swamy, 2014) defined it as the bank's ability to manage its operations in light of emergency events, reflecting its ability to pay debts in the presence of unsuitable economic conditions through the capital and reserve accounts in its possession, while (Noman & Isa, 2021) defined it as the state in which the financial system represented by financial and banking institutions, markets and infrastructure can confront financial shocks and imbalances, which enables it to overcome the occurrence of disturbances in its various operations and activities.

Countries that are highly concerned with the safety of their financial and banking systems try to avoid the high costs they incur as a result of restructuring their systems if they are affected by potential financial crises, which requires regulatory authorities to play their role clearly and significantly through a specialised assessment of the stability of the financial system in order to determine any weakness in the system for any period. To achieve the financial safety of these systems, several basic pillars must be available (faisal Djihad, 2021), which include the existence of stable economic conditions, sound regulation of financial institutions and their periodic monitoring, the availability of stable financial markets and sound financial institutions, the availability of strong and secure infrastructure and financially secure and effective communication networks.

The importance of financial safety in the financial system and the economy as a whole can be described as follows (Noman & Isa, 2021; Ouma & Kirori, 2019): It helps build public confidence and encourages the mobilisation of funds from savers to production units. To support economic activity, a sound financial system is required through transparency of information about current and potential investment opportunities, improving corporate governance, encouraging trade, diversification and risk management. A sound financial system contributes to the intensity of investment and enhances economic growth by encouraging industry, creating job opportunities and generating income. Financial soundness in the banking industry is a guarantee not only for creditors but for all stakeholders (shareholders - investors - employees) and the economy as a whole. It helps achieve comprehensive and sustainable economic growth, increase job opportunities, provide decent work for all, and reduce levels of inequality in the economy. Financial soundness reduces financial distress within the financial system. A financially sound banking sector provides a basis for achieving real profits for the developing economy, ensuring stability in the country's financial and banking system.

RESEARCH METHODOLOGY

In order to test the relationship and impact between bank credit policy and financial safety and to achieve the research objectives, this study utilises the Bankometer model, a tool developed by the International Monetary Fund, to assess financial safety comprehensively. Mathur (2022) underscores the model's utility in evaluating solvency and risk profiles through indicators like capital adequacy and non-performing loans and was accepted all over the world in the following form (Mathur, 2022):

$$S=1.5(CA)+1.2(EA)+3.5(CAR)+0.6(NPL)+0.3(CL)+0.4(LA)$$

Where:

S = Financial solvency score (index)
CA= Capital to assets ratio $\geq$ 4%
EA= Equity to assets ratio $\geq$ 2%
CAR= Capital adequacy ratio $\geq$ 40%
NPL= Non-performing loans to loans ratio $\leq$ 15%

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CI= Cost to income ratio ≤ 40%
LA= Loan to assets ratio ≤ 65%

This model contributes to determining the bank's financial solvency and financial safety position by diagnosing the extent of the bank's ability to pay its financial obligations on their due dates. 50) ≤ S) indicates the existence of financial difficulty and the bank will face major financial risks, 70) ≤ S <50) indicates the grey area and the bank will face a moderate financial situation. In contrast, 70< (S) indicates that banks enjoy financial safety and the ability to meet their obligations on their due dates.

Variables of the Study

To conduct this empirical estimation, the research relied on the following variables. The data on these variables is collected from the official financial reports issued by the bank over the 2014 to 2023 period.

RESULTS AND DISCUSSIONS

Analysis of the Financial Data of the National Bank of Iraq.

First, Table 1 shows the analysis of the growth rates of the credit policy variable, including cash credit and contractual credit. The cash credit indicator shows the extent of the direct cash funds that the bank grants to customers in exchange for certain interest on these funds that must be paid on their due date.

Table 1: Definition and Measurement of Study Variables

Variable	Definition	Indicators
Credit policy	It is a set of foundations and principles that regulate the methods of granting credit facilities and determining the types of economic activities that are allowed to be financed, with determining the levels of the amounts of the facilities required to be granted, their types, periods, and the conditions for granting them.	Cash pledge (including Loans and advances, debit current accounts, discounting of commercial papers and discounting of treasury bills, promissory credit, which include documentary credit and letters of guarantee and warranties)
Financial soundness	The bank's ability to maintain financial solvency meets the needs of fixed and long-term expenses and achieves long-term growth and expansion plans (Ouma & Kirori, 2019).	The financial safety index comprises capital to assets, Equity to assets, capital adequacy, non-performing loans to loans, loans to assets, and cost to income.

It is clearly shown in Table 2 that the growth indicator varied from one year to another during the research years, as the highest growth rate was achieved for the year (2023) by 92%, while the year 2016 recorded the lowest growth rate of 27%. This disparity in the indicators of the growth of the cash credit of the bank indicates that the bank's credit policy was fluctuating between the risky, conservative and moderate policy in granting loans in line with the data of the bank's internal conditions and the external

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circumstances affecting it.

Table 2: Credit Policy Indicators of the National Bank of Iraq for the Period (2014-2023)

Year	Cash Credit Growth (Decline) Rates	Contingent Credit Growth (Decline) Rates
2014	0.7	0.64
2015	0.81	0.3
2016	-0.27	0.31
2017	0.35	0.35
2018	-0.3	-0.2
2019	0.54	0.33
2020	0.46	0.36
2021	0.63	0.45
2022	-0.34	0.5
2023	0.92	0.68
Average	0.35	0.37

Source: Prepared by the Researcher Based on the Financial Reports Published on the Iraq Stock Exchange Website.

Figure 1 shows the National Bank's monetary credit growth rates during the research years. Most of the research years recorded clear growth, averaging 35%. The rate exceeded the average by three times, approximately 92% in 2023, while the decline rates in monetary credit were limited to only three years.

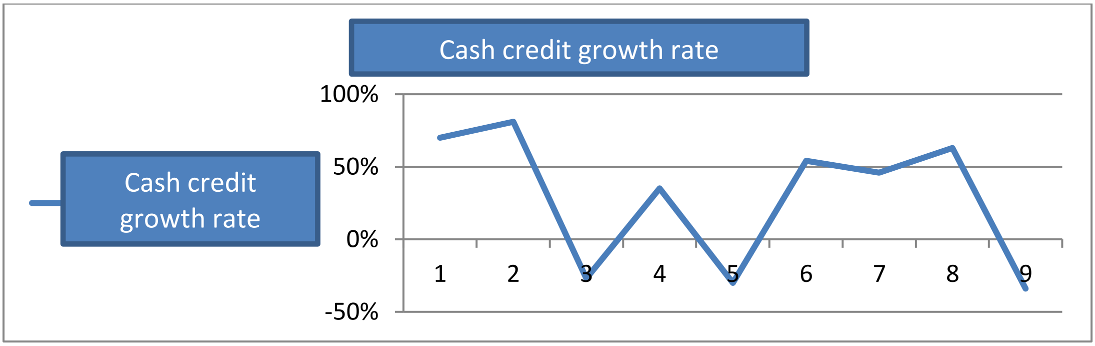

Figure 1: Growth Rates of the Monetary Credit Index for the Research Years (2014-2023)

Secondly, contractual credit reflects the type of facilities provided by the bank to the customer based on requests such as (letters of guarantee and guarantees) in exchange for insurance paid to the bank at a certain percentage of the amount of the credit according to agreed-upon terms. It is evident from Table 1 that the lowest growth rate was -20% in 2018, and the highest growth rate (68%) was achieved in the year 2023. These high and low rates indicate how much this bank is relied upon as an intermediary

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by its clients and contractors in providing guarantees and merchants by opening documentary credit. Figure 2 shows the National Bank's contractual credit growth rates during the research years. Most of the research years recorded a clear growth with an average of 37%, and the year (2023) recorded the highest rate (68%), followed by the year 2014 by 64%, while the rates of contractual credit declined in the year (2018) by -20%.

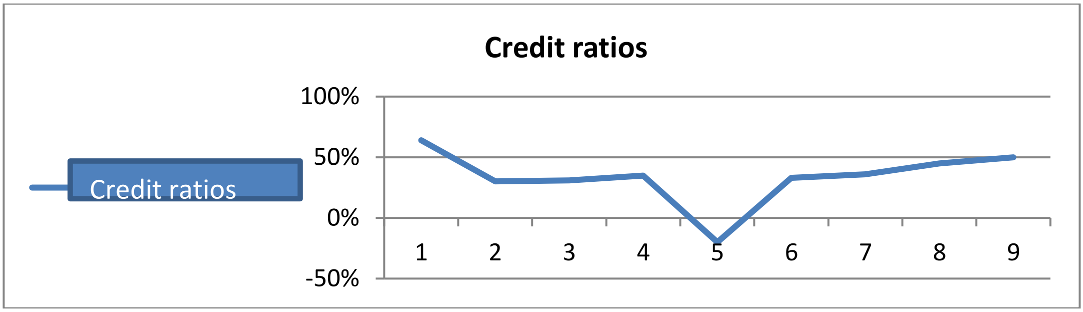

Figure 2: Growth Ratios of the Monetary Credit Index for the Research Years (2014-2023)

Next, Table 3 shows the financial ratios of the financial safety index (S) represented by six financial indicators ((CA) Capital/assets ratio - (EA) Equity/assets ratio - (CAR) Capital adequacy - (NPL) Non-performing loans/loans - (CL) Cost/income - (LA) Loans/assets) for the period (2014-2023).

Table 3: Financial Safety Index (S) and Component Ratios (2014–2023)

Years	CA	EA	CAR	NPL	CL	LA	S
2014	75%	82%	111.5%	52%	76%	81%	69%
2015	82%	79%	116.9%	45%	89%	72%	71%
2016	70%	62%	103.2%	43%	86%	67%	65%
2017	73%	61%	106.6%	48%	73%	74%	64%
2018	67%	77%	82.17%	33%	76%	84%	56%
2019	63%	67%	58.19%	36%	65%	51%	44%
2020	69%	72%	30.91%	52%	62%	55%	37%
2021	64%	65%	25.9%	30%	79%	53%	33%
2022	70%	71%	20.75%	31%	74%	57%	32%
2023	73%	75%	21.16%	24%	83%	52%	33%
Average	71%	71%	68%	39%	76%	73%	51%

Source: Author's Calculation

The Bankometric model determined standard ratios for each financial safety indicator, where the (CA) indicator recorded a general average during the research years of (71%). This value exceeded the standard by a very large percentage (≥4%), and the (EA) indicator recorded a general average of (71%). This value exceeded the standard (≥2%). The capital adequacy index (CAR) recorded a general average of (68%) and exceeded this standard percentage specified by the model, which was (≥40%). The increase in the

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indicators may be interpreted in a positive way that serves the purposes of the bank. This is the case with the capital adequacy index, which reflects its financial solvency reflected in the value of the bank in its business environment.

The (NPL) index recorded a general average value of (39%) compared to the standard percentage specified by the model by (≤ 15%), which means that the level of non-performing loans for the research sample bank was twice the standard percentage. In comparison, the (CL) index recorded a general average of (76%) compared to the standard specified according to the (Bankometer) model by (≤ 40%). The (LA) index recorded the general average of this indicator during the research years by (73%) while the standard value, according to the approved model, was (≤ 65%). Based on the above and by adopting the equation mentioned in the research methodology, we determine the level of financial safety of the research sample bank during the study years according to the approved model, where the general average was (51%) compared to the standard used in the research, the bank exceeded the hardship zone to the grey zone.

Figure 3 shows a chart of the levels of financial safety indicators for the research sample bank during the research years mentioned in Table (3). The bank enjoyed clear financial safety during the first research years (2014-2015-2016-2017-2018), reflecting its stability and survival in the financial market. This is attributed to the bank's enjoyment of high capital efficiency and other indicators. At the same time, in the years (2019-2020-2-2021-2022-2023), the safety index was low, indicating that the bank was going through a state of financial distress according to the standard specified in the Bankometer test model.

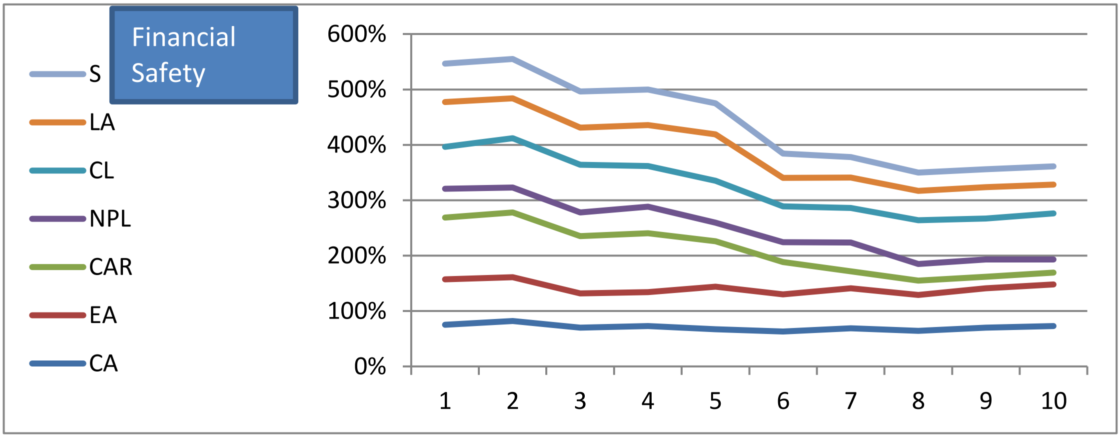

Figure 3: Financial Safety Index for the Research Years (2014-2023).

Correlation Analysis

In order to determine the correlation between the dependent and independent variables, the Pearson correlation method was used, and the findings are shown in Table 4. The correlation test shows the type and strength of the relationship between dependent and

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independent variables. A significant and medium correlation between cash credit and financial safety indicators (CA-EA-CAR - CL) is found. In contrast, the (NPL-LA) indicator recorded an inverse (weak and medium) correlation with cash credit. On the other hand, the correlation between cash credit and safety indicators was inverse and medium.

Table 4: Findings of Correlation Test

Independent Variable	**Dependent variable (financial safety)**							
Cash Credit	Pearson correlation	CA	EA	CAR	NPL	CL	LA	S
		0.433	*0.522*	*0.506*	*0.671-*	*0.354*	*0.234-*	*-0.538*
	Sig.(2.tailed)	*0.021*	*0.012*	*0.040*	*0.029*	*0.004*	*0.015*	*0.019*
	N.	*10*	*10*	*10*	*10*	*10*	*10*	*10*
Promissory Credit	Pearson correlation	*0.188*	*0.648*	*0.641*	*0.521-*	*0.577*	*0.281-*	*-0.523*
	Sig.(2.tailed)	*0.046*	*0.014*	*0.041*	*0.003*	*0.010*	*0.020*	*0.022*
	N.	*10*	*10*	*10*	*10*	*10*	*10*	*10*

Source: Authors' Calculation.

As the second indicator of the independent variable, contractual credit has a weak and medium correlation value with (CA-EA CAR-CL) and an inverse and weak correlation with the indicator (NPL-LA). On the other hand, the correlation of contractual credit with the financial safety indicators was inverse and medium.

Regression Analysis

The simple linear regression equation was relied upon to test the research hypotheses, and the findings are given in Table 5. The impact of cash credit on financial safety was found to be negative. Regarding the coefficient, financial safety decreased by 0.252 units with a one-unit increase in cash credit. This indicates that a reduction in credit policies improves the financial safety or soundness of the banks (Bezemer et al., 2023). The value of the coefficient of determination (R^2) is (0.107), which means that cash credit explains 10% of the change in financial safety. The rest of the change is due to other variables not included in the model. Next, it is also evident that the impact of the contract credit on financial soundness is negative.

Regarding the coefficient, financial soundness decreases by 0.325 units, with each unit increasing contract credit by one unit. This indicates that the bank's expansion in granting credit may negatively affect the financial safety index of the sample bank. Moreover, the value of R^2 is 0.104, which means that contract credit explains 10% of the change in financial soundness, and the rest is due to other variables that were not included in the model.

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Table 5: Findings of Regression Analysis

Credit Policy (Independent Variable)	Financial security (dependent variable)						
	B	Beta	R^2	T	Sig.	f	Sig.
Cash Credit	*0.536*	*0.252-*	*0.107*	*3.709*	*0.006*	*6.05*	*0.019*
Contract Credit	*0.645*	*0.325-*	*0.104*	*4.196*	*0.036*	*9.43*	*0.022*

Source: Author’s Calculation.

CONCLUSION AND RECOMMENDATIONS

Conclusion

The basic purpose of the present study was to analyse the relationship between credit policy and the financial soundness of the National Bank in Iraq over the 2014 to 2023 period. Cash and contract credit were the two most common indicators used to measure credit policy. On the other hand, the Bankometer model was used to measure financial soundness through different indicators, as explained previously. According to the results of the study, the credit policy adopted by the National Bank of Iraq is characterised as a moderate and somewhat conservative policy as reflected in the growth indicators of the variables (cash and contractual credit), whose ratios were somewhat close, and was confirmed by the capital adequacy ratios of the bank during the research years. Despite the increase in these ratios, the bank is granting credit. The bank's financial safety indicators increased during the first 5 years (2014-2018) mainly due to the significant increase in the capital adequacy index, which exceeded the standard ratio. Moreover, the outcomes of the correlation test indicated a positive correlation between the capital adequacy ratio, the equity-to-assets ratio (financial safety indicators) and the credit policy. Furthermore, the regression analysis results showed that the credit policy indicators are inversely related to financial safety. Hence, a decline in credit policy is conducive to fostering the financial safety of the bank.

Recommendations

Based on the findings, it is recommended that banks emphasise financial safety by focusing on their sub-indicators, especially the capital adequacy index and the bad debt provision, as they represent the first line of defence to confront credit risks. The bank must adopt a clear and written credit plan mainly focused on important banking activities consistent with the state's monetary policy and ensuring the diversification of the bank's investment portfolio. Moreover, national banks must adopt more insightful credit assessments to predict default risks better. Strict collateral requirements are required to mitigate the default risks and balance financial stability and credit accessibility. Banks should grant cash and contractual credit to serve financial safety objectives by providing efficient administrative skills in drawing up policies. Furthermore, disseminating banking culture among employees in private commercial banks and introducing them to the most important developments in the banking work environment through training courses and developing their skills in how to grant loans to ensure achieving and maintaining financial safety.

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